IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 1048

IN THE MATTER OF
CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY,
Debtor and Cross Petitioner.

No. 875-883

GROUP OF INSTITUTIONAL INVESTORS, and MUTUAL SAVINGS BANK GROUP,
Petitioners,
vs.
CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, *et al.*,
Respondents.

No. 988

RECONSTRUCTION FINANCE CORPORATION,
Petitioner,
vs.
CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, *et al.*,
Respondents.

CROSS PETITION OF CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

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Dated, New York, N. Y.,
March 16, 1942.

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To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Chicago, Milwaukee, St. Paul and Pacific Railroad Company (herein called the Railroad Company), respondent in the Proceedings Nos. 875-883 upon the Docket of this Court, opposes as unwarranted the granting of a *writ of certiorari* as asked by the Group of Institutional Investors and Mutual Savings Bank Group, the Petitioners therein, for the pur-

pose of a review of the decision of the Circuit Court of Appeals for the Seventh Circuit, filed December 4, 1941. The Railroad Company's reasons for asking that the Petition of these two Groups be denied will be presented in an opposing Brief filed under these Docket numbers.

The Railroad Company nevertheless believes it essential, in order that it may not be held to have accepted as the law of this case the Opinion and Supplemental Opinion of the Circuit Court of Appeals and in order that vital interests of its security holders may be protected, to apply by way of a Cross Petition for a *writ of certiorari* for a review of the decision of the Circuit Court of Appeals on grounds differing from and wholly unrelated to those urged in the Petition filed by the two Groups.

For all purposes of this Cross Petition, the Railroad Company asks leave to refer to the certified Transcript and printed copies of the Records filed by the two Groups, as Petitioners in the Proceedings Nos. 875-883, and further asks that all such documents be deemed to accompany this Cross Petition within the requirements of Rule 38 of this Court.

Reasons for Review

The basic reasons which the Railroad Company urges for a review of the decision of the Circuit Court of Appeals are—

(a) that the decision of the Circuit Court of Appeals should be brought into harmony with the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois*,* and

* This case is reported in 312 U. S., at page 510. In the interest of brevity the citation of the volume and page will be omitted in subsequent references throughout this Cross Petition and the annexed Brief.

(b) that this Proceeding should be referred back to the Interstate Commerce Commission in accordance with subsection (e) of Section 77 of the Act of Congress commonly known as the Bankruptcy Act (11 U. S. C. A., Sec. 205) for reconsideration under the provisions of the preceding subsection (d) unembarrassed by so much of the decision of the Circuit Court of Appeals as is inconsistent with the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois*.

The propriety of a review of the decision of the Circuit Court of Appeals on these grounds is accentuated by the decision of the same Circuit Court of Appeals released February 9, 1942, relating to the pending reorganization of the Chicago and North Western Railway Company, in which that Court appears to have held that compliance with the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois* may be dispensed with after a Plan of Reorganization certified to the District Court by the Interstate Commerce Commission "has the approval of the various groups of creditors"—a conclusion which seems an inexplicable one when it is considered—

(a) that under Section 77 of the Bankruptcy Act judicial approval must *precede* the submission of the Plan to creditors and the very purpose of the requirement for specific findings is to enable the Court properly to perform its judicial functions thereunder, and

(b) that in the present case the Circuit Court of Appeals (we think quite properly) *stayed* the submission of the Plan to the creditors of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company

until the determination of the appeal then pending before it from the decision of the District Court—a stay which it declined to release and which still stands notwithstanding successive applications for its release by the Interstate Commerce Commission and by the two Groups (Tr. 2274; 2296).

For the purposes of this Cross Petition and the annexed supporting Brief, it will be sufficient to specify and limit the discussion to the more conspicuous features of the Plan of Reorganization and the decision of the Circuit Court of Appeals in respect thereto which the Cross Petitioner contends are at fundamental variance with the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois* and which accordingly justify the issuance of a *writ of certiorari* under subdivision (b) of Paragraph 4 of Rule 38 of this Court.

These include—

(a) the treatment accorded holders of the General Mortgage Bonds,

(b) the treatment accorded the holders of the Fifty Year Mortgage 5% Bonds, and

(c) the treatment accorded the holders of the Railroad Company's Preferred Stock and Common Stock.

Even as to these subjects it will be unnecessary to do more than refer to the bald outlines of the Plan.

The financial structure of the Railroad Company is shown in detail in the original Report of the Interstate Commerce Commission (Tr. 2165-2269; Debtor's Court Exhibit 8). The Plan certified to the District Court by the In-

terstate Commerce Commission in tabulated form is attached to the Supplemental Report of the Interstate Commerce Commission (Tr. 1317).

The General Mortgage Bonds are outstanding in the amount of $138,788,000, divided into five Series bearing interest rates varying from 3½% to 4¾%, all maturing May 1, 1989, and secured primarily by a first lien on 6,000 miles of railroad of high traffic density lying between the Missouri River and Lake Michigan. Under the Plan of Reorganization these General Mortgage Bonds, which had weathered every storm in the 46 year period preceding the filing of the Petition under Section 77 of the Bankruptcy Act, are offered for the full principal and accrued interest at the effective date of the Plan—25% in new First Mortgage 4% Bonds, 35% in General Mortgage 4½% Income Bonds, Series A, 20% in General Mortgage 4½% Income Bonds, Series B, and 20% in 5% Preferred Stock (Tr. 1317, 1340).

The Fifty Year 5% Bonds of 1975 are outstanding in the amount of $106,395,096, and are secured by a lien (for practical purposes a first lien) on approximately 3,000 miles of railroad lying between the Missouri River and Puget Sound, and other properties, and by a second lien on all the properties upon which the General Mortgage is a first lien. Under the Plan of Reorganization these Fifty Year Bonds are offered for the full principal and accrued interest at the effective date of the Plan—15% in General Mortgage 4½% Income Bonds, Series B, 60% in 5% Preferred Stock, and 25% in Common Stock (Tr. 1317, 1341).

It is to be noted:

A. that the General Mortgage Bonds lose 75% of their first lien position and their fixed interest charge and

the Fifty Year Bonds lose 100% of their first lien position and their fixed interest charge;

B. that all the General Mortgage Bonds, regardless of Series, are treated alike, although the interest rates upon the different Series vary between a low of 3½% and a high of 4¾% with the discriminatory result that certain Series receive higher aggregate interest on the new securities to be taken in exchange and other Series receive lower aggregate interest;

C. That all of the Fifty Year Bonds receive lower aggregate interest on the new securities than is borne by the Fifty Year Bonds;

D. that the General Mortgage Bonds are relegated to a stock position for 20% of their debt and the Fifty Year Bonds are so relegated for 85% of their debt; and

E. that all existing maturities of both the General Mortgage Bonds and the Fifty Year Bonds are either extended or eliminated by the substitution of stock (Tr. 2167; 2172; 2251; 2255).

No compensation is offered for these radical changes in the character and strategic positions of the General Mortgage Bonds and the Fifty Year Bonds; but, nevertheless, Adjustment Mortgage Bonds in the principal amount of $182,873,693, secured by an indenture *wholly* subordinate to both the General Mortgage and the Fifty Year Mortgage are offered 1,788,655 shares of new Common Stock without par value which (taken at $100 per share) represent an investment of $178,865,500 (Tr. 2172; 2257; 1317).

Although no provision is made under the Plan of Reorganization for the Railroad Company's Preferred and Common Stock, the Interstate Commerce Commission made no Finding of value of the Railroad Company's properties as a whole and under the Supplemental Opinion of the Circuit Court of Appeals a specific Finding of value is held to be unnecessary, in this respect creating a direct conflict with the decision of the Circuit Court of Appeals for the Ninth Circuit in the matter of The Western Pacific Railroad Company, filed November 28, 1941 (Tr. 2335).

The Cross Petitioner submits that these provisions of the Plan of Reorganization and the treatment accorded the Railroad Company's security holders (none of which provisions is required to be modified as a consequence of the Opinion and decision of the Circuit Court of Appeals) involve specific departures from the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois*, disregard the fundamental requirements of subsection (e) of Section 77 of the Bankruptcy Act and create confusion as to the law of the land in matters vitally affecting the public interest.

Other considerations will be presented in the annexed supporting Brief.

WHEREFORE, the Cross Petitioner respectfully prays that a *writ of certiorari* issue to the United States Circuit Court of Appeals for the Seventh Circuit, commanding said Court to certify and send to this Court, on a day to be determined, a full and complete transcript of the record of all of the proceedings had in this cause, to the end that this cause may be reviewed and determined by this Court; that the decree of the Circuit Court of Appeals and the decree of the District Court be reversed; and that this proceeding

be referred back to the Interstate Commerce Commission for reconsideration under the provisions of subsection (d) of Section 77 of the Act of Congress commonly known as the Bankruptcy Act, and further action in conformity with the decision and determination of this Court.

Dated, New York, N. Y., March 16, 1942.

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Brief in Support of Cross Petition

A true appraisal of the Opinion of the Circuit Court of Appeals filed as the basis of its decision in this Proceeding which the Railroad Company asks be reviewed by this Court must start with the premise that the Circuit Court of Appeals, notwithstanding the reversal of the District Court and its reference of the proceeding back to the Interstate Commerce Commission has, with a single possible exception, given its unqualified legal approval of the Plan of Reorganization substantially as certified to the District Court by the Interstate Commerce Commission. The Court, after referring to the decisions in *Consolidated Rock Products Company* v. *Du Bois*, and *Case* v. *Los Angeles Lumber Products Company*, 308 U. S. 106, says:

> "• • • We find nothing in either case which would defeat the plan here in question, *provided the evidence, and necessary findings are made, based on such evidence, and they establish the fairness of the plan.*" (Our italics.) (Tr. 2308.)

It is obvious, therefore, that the proceeding is to be sent back, not to conform the *Plan* to the fundamental requirements of the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois*, but merely for the purpose of revamping the record and underlying data to meet the procedural requirements of that decision; and, in the *Per Curiam* Supplemental Opinion filed January 12, 1942, the Court even relaxes those requirements to the extent of dispensing with any specific Finding of the value of the Railroad Company's property as a whole.

Again in dealing with the provisions made in the Plan for the General Mortgage Bonds, the Circuit Court of Appeals says:

"Accepting, as we do, the necessity for a drastic reduction in indebtedness and interest requirements and realizing that each of these divisions, to a certain extent, depends upon the existence and business of other branches of the system, we are unable to say the evidence fails to establish the fairness of the plan so far as these bonds are concerned.

If the proposition were an original one, it is true, we can readily see how a larger percentage of the new plan first mortgage bonds might have been given to holders of the General Mortgage bonds. On the other hand, while there is a difference in the priorities of the first mortgage bonds and the Series A bonds of the new issue, this may be made up in increased interest rates of the new bonds, especially if the increased revenues of the company, as disclosed during the year 1941, are maintained even in part. There is, however, in our opinion, a serious question presented due to the small percentage (25%) of the First Mortgage bonds given to the holders of old General Mortgage bonds. Our suggestion is that if any revision should be made, this percentage might be increased and the percentage of Series B and preferred and common stock, reduced" (Tr. pp. 2312, 2313).

So we think it quite clear that the Circuit Court of Appeals has approved as lawful the Commission's Plan notwithstanding repeated references in its Opinion to the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois*, and its direct admonition that the Findings which it directs "must be so specific that the court may definitely see that in the new plan, provision for full compensation of cancelled old senior securities, and all prior preferred positions, is made" (Tr. 2315). This language is manifestly meaningless when, as noted in the prefixed Cross Petition, the Plan of Reorganization shows upon its

face that the Railroad Company's General Mortgage Bondholders and Fifty Year 5% Mortgage Bondholders (we quote Mr. Justice DOUGLAS) "have received an inferior grade of securities, inferior in the sense that the interest rate has been reduced, a contingent return has been substituted for a fixed one, the maturities have been in part extended and in part eliminated by the substitution of a Preferred Stock and their former strategic position has been weakened" and not only has "full compensatory provision" in respect of "those lost rights" not been made; but no compensation whatever has been suggested unless it be the Court's vague suggestion that higher interest rates might be placed upon the new Bonds.

That the treatment so accorded the General Mortgage Bonds and the Fifty Year 5% Mortgage Bonds, whose rights are prior in all respects to the Adjustment Mortgage Bonds, runs counter to the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois* cannot seriously be questioned unless the foregoing as well as the following language from the opinion of Mr. Justice DOUGLAS means something quite different from what it plainly says (the words within the parentheses being our own interpolations):

> "• • • Clearly, those prior rights are not recognized, in cases where stockholders (or junior creditors) are participating in the plan, if (senior) creditors are given only a face amount of inferior securities equal to the face amount of their claims. They must receive, in addition, compensation for the senior rights which they are to surrender. If they receive less than that full compensatory treatment, some of their property rights will be appropriated for the benefit of (junior creditors or) stockholders without compensation. That is not permissible." (pp. 528, 529).

The Plan in almost every major adjustment involves a wholly inadmissible inequality or other violation of the priorities both relative and absolute, all of which are impliedly if not expressly sanctioned by the Opinion of the Circuit Court of Appeals; and, unless this Court intervenes to settle the law, these infirmities are almost certain to reappear in and to invalidate such substitute Plan as a bewildered Interstate Commerce Commission shall hereafter formulate.

It may be admitted (and counsel would be lacking in the candor due this Court if they failed to admit) that the doctrine of absolute priority as asserted by the Court in *Consolidated Rock Products Company* v. *Du Bois* extends that doctrine beyond what we had theretofore assumed to be its fixed boundaries. Our assumption had been that it was permissible to allot junior lien bonds or even preferred stock in adjustment of senior debt and to reduce interest or convert fixed interest into contingent interest without making compensation therefor so long as the priority as regards future income was protected and preserved. It seems evident that we had misconceived the rule but even if there has been an extension or broadening of its application, the development is a salutary one in the direction of greater protection of property rights and more scrupulous respect for the inviolability of contract.

The Railroad Company accepts in its full vigor and with all of its implications the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois*. As a just corollary it asks that it and its security holders in the order of their rights and priorities be given all of the benefits implicit in that decision.

To give adequate compensation to the various issues of Mortgage Bonds whose sacrifices are as extreme as those here indicated places what manifestly is a heavy burden upon the Railroad Company's Preferred and Common Stock.

The Railroad Company is nevertheless prepared to assume that burden.

In spite of the pessimism which permeates the Opinion and Supplemental Opinion of the Circuit Court of Appeals and which reflects the shaken morale of the two Groups who for reasons it would be interesting to trace are supporting the Commission's Plan, the Railroad Company maintains that rail transportation is not a decadent industry but is on the contrary an industry conspicuously on the upgrade, an industry achieving results in operating economy and efficiency of a character and extent until recently unthought of even by its own experts. This is graphically shown by the figures in the Transcript and is given striking emphasis by the current published figures of all Class 1 Carriers—figures of which this Court will, we believe, unhesitatingly take judicial notice under authorities hereinafter cited.

Let us, in developing this idea, first point out what is disclosed by the Report of the Interstate Commerce Commission as the basis of its negative Finding that the Preferred Stock and Common Stock was without value.

After showing that the present cost of reproduction new and less depreciation and the original cost of the Railroad Company's properties and its investment therein and its value for the rate base under Section 19A of the Interstate Commerce Act all exceeded by wide or substantial

margins the amount of its indebtedness, the Interstate Commerce Commission said:

> "* * * The total debt of $626,926,331 corresponds approximately to an available income of $28,212,000 capitalized at the low rate of 4½ percent. Only in 1928 and 1929 was such earning power demonstrated. We think that the examiner erred in finding a prospective equity for the preferred stock on the basis of $24,459,932 of average available income during the period 1925-29. That amount exceeds the annual charges on the principal of the present debt but does not take into consideration the large accrual of unpaid interest; in addition, it greatly exceeds the amount earned in any year since 1929. Computations were made by counsel for the committee and introduced at the oral argument showing the interest charges on the total debt at more than $29,000,000 a year. We disagree with the debtor in its contention that the high earning power of the system only 10 years ago indicates the injustice of resolving all uncertainties for the future in such a manner as to forfeit the stock. There is no evidence whatever to indicate that a recovery of the earning power of 1928-29 is reasonably probable, and we regard it as a remote possibility only, which may not be utilized to support a finding that the debtor's stockholders have an equity. In view of the earnings situation it would be improper to give controlling weight to the fact that the indicated reproduction—cost value of the property exceeds the amount of debt. We find that the equity of the holders of the debtor's preferred stock and its common stock has no value and the holders of claims in classes 24 and 25, therefore, are not entitled to participate in the plan" (Tr. 2259, 2260).

From this it is clear that the Interstate Commerce Commission attempted no Finding of value and did not make

any effort, as this Court's opinion in *Consolidated Rock Products Company* v. *Du Bois* plainly indicates is imperative, "to value the whole enterprise by a capitalization of prospective earnings." All that the Interstate Commerce Commission did was to venture a guess that a recovery of the earning power of 1928 and 1929 was not likely to occur. Nor was there even a Finding as to the amount of the annual fixed and contingent interest ahead of the stock at the date of the Plan, a factor without which the existence or non-existence of value for the stock could not possibly be determined. The importance of this is apparent when the status of $79,550,055 of interest accrued but unearned on the Adjustment Bonds is left undetermined. In interpreting the Opinion of this Court in the *Consolidated Rock Products* case, the Circuit Court of Appeals seems to have assumed that unearned contingent interest should be excluded (Tr. 2308, clause (b)).

The Railroad Company respectfully submits that this proceeding should be referred back to the Interstate Commerce Commission under subsection (e) of Section 77 with an absolute and unconditional right on the part of the Railroad Company and any party in interest to file a new Plan and to support such new Plan with additional up to date evidence: and it respectfully challenges the power or right of the Circuit Court of Appeals to refer the proceeding back to the Interstate Commerce Commission under a mandate such as is proposed in its *Per Curiam* Supplemental Opinion purporting to give the Interstate Commerce Commission an unreviewable discretion to refuse to receive evidence which parties in interest may see fit to offer in the protection of their property rights. But, assuming for argument that the Circuit Court of Appeals does possess such power or right, we again respectfully

submit that its exercise in this proceeding was so unreasonable, so erroneous and so in conflict with controlling decisions of this Court as alone to justify the issue of a *writ of certiorari* under Rule 38 of this Court.

The effective date of the Plan is December 31, 1938. The last hearing in the Interstate Commerce Commission was March 22, 1938. The final submission to the Interstate Commerce Commission was on April 12, 1939, and the original Plan was released by the Interstate Commerce Commission on February 12, 1940 (Tr. 692-1158; 2153-2269).

This Court will, as we confidently believe, take judicial notice of two facts of great significance, first, that the evidence before the Interstate Commerce Commission was closed at the very lowest point of the economic recession which set in late in 1937 and that since that time railway earnings have increased progressively until they have reached a point unprecedented in the history of the industry.

In the case of *Atchison, Topeka and Santa Fe Railroad Company* v. *United States*, 284 U. S. 248, this Court said:

> "There can be no question as to the change in conditions upon which the new hearing was asked. Of that change we may take judicial notice. It is the outstanding contemporary fact, dominating thought and action throughout the country. As the Interstate Commerce Commission said in its recent report to the Congress, 'a depression such as the country is now passing through is a new experience to the present generation.' The Commission also recognized in that report 'the very large reductions in railroad earnings which have accompanied the economic depression,' and stated that 'the chief cause

> these reductions has been loss of traffic.' For 'in such depressions the railroads suffer severely.' Their traffic is a barometer of general business conditions" (p. 260).

If, as is here held, the Court will take judicial notice of the existence of a depression and its reaction upon the business and revenues of our railway transportation system, it must follow that it will take judicial notice of the ending of that depression and the vast economic changes underlying the present day unprecedented prosperity of our railways.

In the case of *Central Kentucky Natural Gas Co.* v. *Railroad Commission of Kentucky, et al.*, 290 U. S. 264, the Court reiterated the above rule and held that judicial notice may be taken of changes in values, costs of service, consumption of commodities, and reasonable return on invested capital which have taken place during the period in which a case is pending before a commission and in a District Court.

For the very restricted purpose of a Supporting Brief upon application for a *writ of certiorari*, it will be sufficient to limit the discussion to the earnings of the Railroad Company for 1941 and the month of January, 1942. As already pointed out, the Interstate Commerce Commission wiped out the Preferred Stock and Common Stock of the Railroad Company because it regarded as remote a recovery of the earning capacity shown in 1928 and 1929.

Let us consider this in the light of what has since happened.

In so doing we ask the Court to bear in mind that earning capacity consists of at least two factors—(1) the capacity to attract tonnage to the rails that will produce gross receipts or (as termed in railway accounting) Railway

Operating Revenues, and (2) the capacity to convert or translate Railway Operating Revenues into Net Railway Operating Income, which may be less or may be more but ordinarily closely approximates the Income Available for Fixed Charges.

The Interstate Commerce Commission failed to disclose which of these factors it had in mind when it made its ill-fated guess, but that is not now material because it is quite evident that it was wrong as to both.

In 1929, when Railway Operating Revenues reached the all-time high of $171,361,385, the Income Available for Fixed Charges was $30,128,682 (Debtor's Court Exhibit No. 5).

In 1941, the Railway Operating Revenues were only $139,646,122, but the Income Available for Fixed Charges, as shown by the published reports of the Trustees, actually reached $28,939,719.* This figure is, however, believed to have been artificially depressed by extraordinary maintenance in the month of November and by the inclusion in the month of December of the entire wage increase retroactive for four months to September 1, 1941, without, of course, any offset for the increases in passenger and express rates already granted, or the increase in freight rates announced March 2, 1942. The Railroad Company would, if permitted to do so, undertake to prove in the Interstate Commerce Commission that the true figure for 1941 should closely approximate, if not exceed, the estimate referred to in the Opinion of the Circuit Court of Appeals of $31,140,683 (Tr. 2310). But it is immaterial for present purposes whether the true Income Available for Fixed Charges for 1941 was $28,939,719, as published by the Trustees, or

* Figures filed January 26, 1942, with the Interstate Commerce Commission and contemporaneously released to the Press.

$31,140,683, as estimated by the Railroad Company, or something more, because either figure is sufficient to cover *all* interest charges in the same period on the basis of any fair calculation; so that all gains in 1942 and subsequent years over 1941 will reflect the earning power or value of the Railroad Company's present stock (Tr. 2259).

Passing then from 1941 into the present year, we find that in the month of January, 1942, Railway Operating Revenues increased more than 30% over the corresponding month of 1941 with the following significant result:

NET RAILWAY OPERATING INCOME
1942 v. 1941

*1942**	*1941*	*Increase*
$3,004,388	$1,756,422	$1,247,966

It thus appears that Railway Operating Revenues are running ahead of 1929 and that Net Railway Operating Income has increased in January, 1942, to the extent of $1,247,966, notwithstanding full absorption of the recent wage increase and without the benefit of the 6% increase in freight rates announced by the Interstate Commerce Commission on March 2, 1942. If this gain is maintained throughout the year 1942 (we think it should be greatly exceeded) the Railway Operating Income for 1942 in excess of what was earned in 1941 should amount to $14,975,592, so that the income available for dividends, assuming the full increase to be subject to the 31% Federal tax and deducting $4,642,433 therefor, will be $10,333,159, an amount sufficient to provide for the 5% dividend on $119,307,300 of Preferred Stock and to leave $4,367,794 available for 1,174,060 shares of Common Stock.

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* Figures filed February 26, 1942, with the Interstate Commerce Commission and contemporaneously released to the Press.

Certain features of this truly remarkable demonstration of earning capacity ought to be emphasized. First of all, it is quite apparent that the high net income in a very large measure results not from abnormal tonnage created by the war but from vastly increased operating efficiency and to that extent is permanent. The figures speak for themselves and are conclusive. A comparison of the figures for 1929 as against 1941 has already been supplied. The property earned approximately as much in 1941 as it earned in 1929 although Railway Operating Revenues in 1941 were $31,715,263 *less* than in 1929. A comparison between 1930 and 1941 is of equal significance. In 1930, with Railway Operating Revenues of $142,569,632, the property earned $18,979,408 as Available for Fixed Charges, whereas in 1941, with Railway Operating Revenues of only $139,696,122, the property earned as Available for Fixed Charges not less than $28,939,719. These factors are of vital importance under the decision of this Court in *Consolidated Rock Products Company* v. *Du Bois* because they demonstrate beyond the possibility of legitimate controversy that "the past earnings record" which was the Commission's only guide when it determined to extinguish the stock was not "a reliable criterion of future performance" (Opinion of Mr. Justice DOUGLAS, at p. 526). For that reason, if for no other, the proceeding should, we submit, be remanded to the Interstate Commerce Commission with directions to make a thorough-going study of the causes underlying the greatly increased capacity of the Railroad Company to translate gross revenue into net income and to include the results of its study as part of the factual data supporting its valuations under subsection (e) of Section 77 of the Railroad Company's properties as a whole and by mortgage sections.

Nor can the greatly increased tonnage which is moving over the Railroad Company's rails be disregarded in an appraisal of its earning power on the theory that the tonnage is an incident of the war and hence temporary. The fact is that it is the result of changed economic conditions, the duration of which no one can forecast. The war is only one of many factors but even the war may continue far into the future. Should it, as we all hope, end abruptly, inevitably it will be followed by a rebuilding program in Europe, in Asia, and elsewhere that may reasonably be expected to put upon our rails a traffic far in excess of any that could be measured by the past. The competition of the Panama Canal which heretofore was so devastating to the transcontinental railways is no longer significant and may never be restored. The world will need a new merchant marine to take the place of what is now being destroyed—millions of tons of iron and steel will move from our great industries to shipyards in the Pacific, the Atlantic, the Gulf of Mexico and the Great Lakes. These and other obvious sources of tonnage should assure for a period at least equal to the full service life of their present rails a splendid prosperity for our rail transportation systems.

The Railroad Company respectfully submits that this proceeding should be referred back to the Interstate Commerce Commission, not only for a complete set of Findings supported by adequate underlying data giving effect to economic changes since its original Report, but also for a radical revision of the Plan of Reorganization to conform to the fundamental requirements of this Court's decision in *Consolidated Rock Products Company* v. *Du Bois*.

In order that this may be done, unclotured hearings should be held by the Interstate Commerce Commission.

All that the Railroad Company seeks on behalf of its creditors and stockholders is a fair chance at hearings of that character held under a mandate from this Court to prove in support of a fair, equitable and non-discriminatory Plan of Reorganization conforming to the requirements of *Consolidated Rock Products Company* v. *Du Bois* its vastly increased earning capacity as the basis of true valuations of its properties as a whole and by mortgage sections to the extent that earning capacity is a factor to be considered under the law of the land.

In conclusion, the Railroad Company wishes to emphasize that its position under Section 77 of the Bankruptcy Act is *quasi* judicial and that it may and does speak for and in a very large measure represent both creditors and stockholders. By the title as well as by the terms of Chapter VIII of the Bankruptcy Act of which Section 77 forms a part, the Statute is one (note Section 73) "for the relief of debtors"; but, as the very first step to be taken thereunder after the approval of the Petition, the Railroad Company, as the Debtor, is required to surrender its entire estate to one or more trustees whose appointment is made mandatory. Subject to one exception found in subsection (g) which provides for a dismissal of the proceeding if there is undue delay, the only means whereby the Railroad Company may retrieve and receive back its properties so placed in judicial custody and obtain the relief for which Section 77 provides is by securing the approval of a Plan of Reorganization which is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, is non-discriminatory and otherwise complies with Section 77. The Railroad Company is therefore just as much interested in developing a Plan that is fair and equitable to its creditors as it is in securing a Plan that

affords due recognition to its stockholders and it believes that when this proceeding is remanded to the Interstate Commerce Commission such a Plan of Reorganization giving it the relief which the Statute contemplates may readily be developed within the principles and requirements and subject to all of the limitations of *Consolidated Rock Products Company* v. *Du Bois.*

To this end it asks that a *writ of certiorari* issue in accordance with the prayer of its Cross Petition.

Respectfully submitted,

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March 16, 1942.

APPENDIX B.

REASONS STATED BY THE COMMISSION AND THE DISTRICT COURT, RESPECTIVELY, FOR THEIR CONCLUSIONS CONCERNING CAPITALIZATION AND CAPITAL STRUCTURE OF REORGANIZED COMPANY, LACK OF VALUE OF STOCK, PERMISSIBLE FIXED CHARGES, ADDITIONS AND BETTERMENTS FUND AND ALLOCATION OF NEW SECURITIES.

Subject	*Conclusion*	*Reasons*
	(A) STATED BY THE COMMISSION:	
1. Capitalization and Capital Structure of Reorganized Company.	"* * * we are of the opinion and find that the total capitalization of the new company should not exceed approximately $108,780,470 of fixed-interest debt, $115,257,480 of contingent interest debt, $108,675,971, par value, of preferred stock, and 2,158,194 shares of common stock, having no-par value. Taking the common stock at $100 a share, the approximate maximum capitalization would thus be $548,533,321. Total fixed-interest charges will approximate $4,269,654, and total interest charges $9,489,134 per annum. Including the mandatory payment to the capital fund and a sinking fund for the retirement of bonds, the charges ahead of dividends on the new preferred stock will be about $512,532,528 per annum. Giving effect to full 5 percent dividends on the pre-	The Commission's conclusion as to the permissible capitalization and capital structure as quoted in the opposite column is stated to have been based upon the following reasons: (1) "Considering the past and prospective earnings of the debtor and all other relevant facts, and the public interest, we are of the opinion and find * * *" (R. 2218). (2) The past earnings record over an eighteen year period (1921-38) is set forth at R. 2180. (3) The forecasts of prospective earnings and earning capacity are set forth at R. 2185-6 and R. 2190-1. (4) The Commission stated that, "In determining the capitalization of the reorganized company, the committee [Group of Institutional Investors] accorded predominant weight to the earning

Subject	Conclusion	Reasons
1. Capitalization and Capital Structure (continued).	ferred stock the charges ahead of dividends on the common will be about $17,966,326 per annum." (R. 2218-9)	power of the system. T committee states, h ever, that the cost of production of the pr erty, less depreciation, well as the original c should not be ignored fixing the new capital tion, that these factors important in a determi tion of the rate base, that account must taken of the rate base making any estimate earnings." (R. 2188) (5) "All other relev facts" which the Comm sion stated that it considered in reaching conclusion in respect the permissible capital tion and capital struct included the following (i) The facts shown the two traffic stu made by the Comm sion's Bureau of Fina Accountants, consisting 101 schedules analy in statistical form e principal commodi transported by the def railroad, 78 pages of c ments upon and analy of freight traffic tren movements of traffic and from each of the ritories, the possibility exhaustion and dura of production, the ef of competitive transpo tion agencies and num ous other factors, an study of railway ope

Subject	*Conclusion*	*Reasons*
1. Capitalization and Capital Structure (continued).		ing revenues other than freight. (R. 2176) (ii) The original cost of the properties, cost of reproduction new, cost of reproduction less depreciation, value of lands and rights, and working capital. (R. 2164) (iii) Effect of depression and kinds of commodities in which the losses were most pronounced as shown by a study over a 7-year period. (R. 2177) (iv) Analyses of the events leading to bankruptcy. (R. 2177-8) (v) The physical condition of the property with reference to maintenance and efficiency of operation. (R. 2179) (vi) Careful consideration of the plans of reorganization which were submitted by the Group of Institutional Investors and the debtor, respectively, and of the positions taken by all other parties. (R. 2188-2200, 2200-6, 2207-12)

(B) STATED BY THE DISTRICT COURT:

"The Court feels that the Commission in determining the maximum permissible capitalization and fixed charges which the Debtor could reasonably be expected to meet, . . . gave adequate con-

"The Commission points out that the fixed interest charges under the capitalization provided in the Plan, amounting to $4,269,654, together with the mandatory Additions and Betterments Fund of $2,-

Subject	Conclusion	Reasons
1. Capitalization and Capital Structure (continued).	sideration to all elements which should be considered in determining such questions and that the Commission's conclusions as to those matters are sound." (R. 1875)	500,000 making a total of $6,769,654, would be covered about 1.16 times by the average earnings of the period from 1931 to 1935 and 1.18 times for the period from 1932 to 1936. It is pointed out that in the years 1932, 1935 and 1938 such an amount was not earned and the Commission concludes that 'between the clear demands of a conservative policy in the present reorganization and the claims and rights of first lien bondholders, we conclude that the limitation of fixed charges of the system at approximately $4,269,654 a year is reasonable and proper.'" (R. 1875)
	(A) STATED BY THE COMMISSION:	
2. Lack of Value of Stock.	"We find that the equity of the holders of the debtor's preferred stock and its common stock has no value and the holders of claims in classes 24 and 25, therefore, are not entitled to participate in the plan." (R. 2260)	(1) "The last year when dividends were paid on the stock was in 1917." (R. 2259) (2) "The record of the Milwaukee's earnings from 1910 through 1938 supports the finding that the stock is without value." (R. 2259, referring to earlier statement of the earnings record in Commission's report at R. 2180) (3) "Between 1930 and 1936 the income available for payment of inter

Subject	*Conclusion*	*Reasons*
Lack of Value of Stock (continued).		est, as adjusted by the committee and accepted by the debtor, varied between a high level of $20,298,074 and a low of $2,680,530, with an average of $10,270,360. Similarly adjusted, the available income in 1937 was $8,224,809 and in 1938 $6,023,296, bringing the average 1930 to 1938, to $9,571,180. Future normal earnings were estimated by the committee at $15,894,000 a year. When these amounts are compared with the annual interest charges on the principal of the present debt, $23,739,000 a year, it is evident that the earning power of the system since the period of peak earnings is entirely inadequate to cover the principal of the debt, disregarding more than $118,000,000 of unpaid interest." (R. 2259) (4) "The total debt of $626,926,331 corresponds approximately to an available income of $28,212,000 capitalized at the low rate of 4½ percent. Only in 1928 and 1929 was such earning power demonstrated. We think that the examiner erred in finding a prospective equity for the preferred stock on the basis of $24,-

Subject	*Conclusion*	*Reasons*
2. Lack of Value of Stock (continued).		459,932 of average available income during the period 1925-29. That amount exceeds the annual charges on the principal of the present debt but does not take into consideration the large accrual of unpaid interest; in addition, it greatly exceeds the amount earned in any year since 1929. Computations were made by counsel for the committee and introduced at the oral argument showing the interest charges on the total debt at more than $29,000,000 a year. We disagree with the debtor in its contention that the high earning power of the system only 10 years ago indicates the injustice of resolving all uncertainties for the future in such a manner as to forfeit the stock. There is no evidence whatever to indicate that a recovery of the earning power of 1928-29 is reasonably probable, and we regard it as a remote possibility only, which may not be utilized to support a finding that the debtor's stockholders have an equity. In view of the earnings situation it would be improper to give controlling weight to the

Subject	*Conclusion*	*Reasons*
2. Lack of Value of Stock (continued).		fact that the indicated reproduction-cost value of the property exceeds the amount of debt." (R. 2259-60) (5) "As of December 31, 1937, the total of funded debt of the system unmatured, including that of the Terre Haute, loans and bills payable, funded debt matured unpaid, interest matured unpaid, unmatured interest accrued, and accrued interest on the adjustment-mortgage bonds was $606,107,641. As of December 31, 1938, the total funded debt of the system, on the basis used herein, was $508,047,413, and the amount of interest accrued and unpaid $118,878,918, a total of $626,926,331. "The latest balance sheets of record show the debtor's investment in road and equipment, as of December 31, 1937, as $691,592,842, and the Terre Haute's investment in road and equipment, as of April 30, 1937, as $28,352,790, a total of $719,945,632. The amounts of accrued depreciation (equipment) were shown as $50,219,918 and $67,872, respectively. For the Milwaukee, total current assets, deferred assets,

Subject	*Conclusion*	*Reasons*
2. Lack of Value of Stock (continued).		and unadjusted credits aggregated $37,518,716, as compared with $23,543,437 of current liabilities, deferred liabilities, and unadjusted credits after deducting depreciation charges and the items included in the amount shown above for total debt and the interest accrued thereon. "The reproduction cost of the system properties, as hereinbefore stated and explained (R. 2164) was $662,759,838." (R. 2258-9)

(B) STATED BY THE DISTRICT COURT:

The Finding of the Commission that the equity of the preferred and common stockholders of the Debtor (Classes 24 and 25) has no value is affirmed. (R. 1991)

(1) "The record shows that no dividends have been paid upon the stock of the Debtor or its predecessor since 1917." (R. 1873)

(2) "Even in the ten-year period ending with 1930, which included the peak years of 1928 and 1929, income available for interest fell far short of the amount needed to service the funded debt which was less than on January 1, 1939, the effective date of the Plan. This condition has been brought about not entirely by the financial depression but has been contributed to by many fac-

Subject	*Conclusion*	*Reasons*
Lack of Value of Stock (continued).		tors such as increased costs, taxes, wages, competition in other forms of transportation and the like. In no year since 1930 has the income available for interest been equal to the amount required under the proposed Plan to meet charges ahead of dividends." (R. 1873) (3) "The objectors [the debtor and the preferred stockholders committee] do not dispute any of the facts embodied in the elements considered by the Commission in reaching its conclusions but the contention is made that the outlook for the future is bright and the prospect for increased earnings promising and this situation, it is claimed, justifies a finding of some value for the equity owners. An expert was called who voiced this view and expressed at some length his opinion as to future earnings. That witness expressed the view that the Debtor's properties were efficiently operated and were in good physical condition and that he felt, in the light of the present tendencies, that it was not too much to expect that a time might be reached, sometime in the future,

Subject	Conclusion	Reasons
2. Lack of Value of Stock (continued).		when the railroad n earn a sufficient am to have available fo payment of interest 300,000. That time referred to as the f normal year but the ness was unwilling to venture a guess such time might a Moreover, if such amount were earned available for the pay of interest, the cap zation of this amou four per cent would duce slightly over 000,000 which is a amount than the pe sible capitalization by the Commission. the Plan approved Commission, if 300,000 were availab the payment of in there would onl enough to pay divi on the new pre stock and none on th common, assuming additional amount f ditions and better contemplated by th were authorized Board of Director the preferred stock the Plan represen interest of present holders. If applied existing indebtedn cluding unpaid accr terest to January such an amount

Subject	*Conclusion*	*Reasons*
2. Lack of Value of Stock (continued).		fall short by some $9,000,000 of paying interest at the average existing rate carried by the obligations of the Debtor." (R. 1873-4)
	(A) STATED BY THE COMMISSION:	
3. Permissible Fixed Charges.	"• • • we conclude that the limitation of fixed charges of the system at approximately $4,269,654 a year is reasonable and proper." (R. 2219)	(1) "The committee based its proposed fixed charges on a coverage of 1.2 times the average annual earnings for the five years 1931-35, considered to be a minimum. The annual payment to the additions and betterments fund was considered, not in connection with the debtor's past earnings but in connection with the estimate for the future normal year, upon which basis the income available for payment of contingent interest was determined after deducting the proposed fixed interest charges and the proposed payment into the additions and betterments fund. A sounder course would be to include the obligatory payment for the fund with the proposed fixed interest charges, keeping the total within the coverage of past average earnings, determined as before. If fixed interest charges be limited to about $4,269,654 and the mandatory pay-

Subject.	Conclusion	Reasons
3. Permissible Fixed Charges (continued).		ment to the fund to $2,500,000 a year, the total, $6,769,654, would be covered about 1.16 times by the average earnings of the period 1931-35 and 1.18 times for the period 1932-36. In 1932, 1935 and 1938 such an amount was not earned. While 1939 shows an improvement in earning power, we would regard any increase in the foregoing charges as hazardous. Between the clear demands of a conservative policy in the present reorganization and the claims and rights of the first-lien bondholders, we conclude that the limitation of fixed charges of the system at approximately $4,269,654 a year is reasonable and proper. We find that there will be adequate coverage of such amount of fixed charges of the new company by the probable earnings available for the payment thereof." (R. 2219) (2) In denying the request for additional fixed interest charges totaling only $300,000 per annum the Commission stated in its supplemental report: "As we indicated in our prior report, no increase in the amount of future fixed charges should be permitted. The petition contains no new

Subject.	*Conclusion*	*Reasons*
3. Permissible Fixed Charges (continued).		facts or considerations which justify a material alteration in the capital structure and allocation of securities previously arrived at in our best judgment. A reasonable margin above fixed charges operates not only to the advantage of the company in times of depressed earnings but also to the benefit of the holders of contingent interest bonds and to the marketability of all classes of the securities." (R. 1298)
	(B) STATED BY THE DISTRICT COURT:	
	(See 1(B) above which also covers permissible fixed charges.)	
	(A) STATED BY THE COMMISSION:	
4. Additions and Betterments Fund.	"'We think that the situation will be met by the provisions for the additions and betterments fund hereinafter made, by which the contributions to the fund in respect of any income period will be part mandatory and part in the discretion of the management.'" (R. 2223) Thereafter the Commission stated in specific detail the terms of the additions and betterments fund approved by it. (R. 2237-2241)	The Commission first summarized the terms proposed by the parties for the fund, and the debtor's showing of the annual charges to additions and betterments each year from 1928 to 1937, together with a statement of the cash obtained each year from equipment depreciation charges, road retirements, and salvage, and the testimony as to future needs of the property. (R. 2192, 2203) On the basis of the full consideration of the

Subject	Conclusion	Reasons
4. Additions and Betterments Fund (continued).		subject the Commission stated: "It appears that the committee considers that approximately $10,700,000 of cash will be available annually for the additions and betterments fund and the reserve and retirement fund, such amount including retirements, salvage, and depreciation on equipment, while the debtor estimates its average capital requirements for the next five years at about $12,900,000 a year, leaving $2,200,000 or more, which, if the expenditures were not curtailed, would have to be financed by the issue and sale of new securities. Testimony for the debtor tends to support the foregoing estimate of future requirements but in such a matter exactness cannot be expected." (R. 2223)
	(B) STATED BY THE DISTRICT COURT:	
	"The necessity for an adequate Additions and Betterments Fund in the maintenance and operation of any railroad is obvious." (R. 1888)	"There is ample evidence in the record to support the conclusion that the amount of $2,500,000 provided for this purpose is necessary in addition to the funds available from equipment depreciation charges and road retirement charges in operating expenses and sal

Subject	*Conclusion*	*Reasons*
4. Additions and Betterments Fund (continued).		age recovered from property retired. Such additional amount must either be provided out of earnings or the railroad must borrow it. In the light of railroad experience in the past, it would seem preferable that such requirements be met from earnings. Reasonable provision for additions and betterments to be paid out of earnings does not, it is believed, violate any rights of the security holders." (R. 1888)
5. Allocation of New Securities.	In regard to the various allocations, the Commission stated: "We conclude" and then set forth in detail the treatment provided for the respective classes. The allocations are shown in tabular form at R. 1317. The District Court, after a very full discussion, approved these conclusions. Record references to the pages on which appear the conclusions of the Commission and the District Court, respectively, concerning the allocations to the respective classes are listed on the following page.	Because of the length of the statement of reasons by both the Commission and the District Court in support of the allocations provided under the plan, it is not feasible to quote from the report and opinion. Instead, record references to the pages of the report and opinion, on which the reasons for the respective allotments are stated are listed on the following page. In respect to each claim, the amount of the claim, the results of the earring studies, and the elements of physical value, are set forth at the record pages listed. Numerous other considerations are discussed in respect of the allocation made to particular classes. In addition the reasons stated

Subject	Conclusion	Reasons
5. Allocation of New Securities (continued):		by the Commission and the District Court for the permissible capitalization and capital structure, which necessarily limit and in large part determine the permissible allocations, are set forth in No. 1 above.
(a) General Mortgage Bonds.	Commission: R. 2251; District Court: R. 1889.	Commission: R. 1304, 1307, 2166-7, 2215, 2250-1; District Court: R. 1886-9.
(b) First and Refunding Mortgage Bonds, all of which are pledged with the Reconstruction Finance Corporation.	Commission: R. 2248; District Court: R. 1889.	Commission: R. 2170-3, 2246-8; District Court: R. 1889.
(c) Fifty Year Five Per Cent. Mortgage Bonds.	Commission: R. 2255; District Court: R. 1890.	Commission: R. 1307-8, 2172, 2247, 2251-5; District Court: R. 1889-90.
(d) Convertible Adjustment Mortgage Bonds.	Commission: R. 2256-7; District Court: R. 1891.	Commission: R. 1308, 2172, 2252-7; District Court: R. 1891.
(e) Milwaukee & Northern Mortgage Bonds.	Commission: R. 2249, 2251; District Court: R. 1886.	Commission: R. 2168, 2248-9, 2250-1; District Court: R. 1885-6.
(f) The Terre Haute Leased Line Bonds.	Commission: R. 2249-50; District Court: R. 1885.	Commission: R. 1301-4, 2169-70, 2212-18, 2249-50; District Court: R. 1876-85.
(g) Chicago, Milwaukee & Gary Mortgage Bonds.	Commission: R. 1315, 2258; District Court: R. 1891.	Commission: R. 1308-11, 2170, 2257-8; District Court: R. 1890-1.